

Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 AID-05 CEA-01 CIAE-00 COME-00 EB-07
EA-07 FRB-03 INR-07 IO-13 NEA-10 NSAE-00 USIA-06
OPIC-03 SP-02 TRSE-00 LAB-04 EPG-02 SIL-01
AGRE-00 OMB-01 SS-15 NSC-05 XMB-02 L-03 /110 W
-----312023Z 009811 /73

R 311931Z MAY 77
FM AMEMBASSY PARIS
TO SECSTATE WASHDC 3392
INFO AMEMBASSY MADRID

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PASS: CEA, TREAS, FRB

E.O. 11652: N/A
TAGS: OECD, ECON
SUBJECT: ECONOMIC AND DEVELOPMENT REVIEW COMMITTEE
(EDRC) REVIEW OF SPAIN

REF: EDR(77)13

1. SUMMARY: AT MAY 24 EDRC REVIEW OF SPAIN, SPANISH
DEL (LED BY MANZANO, MINISTRY OF FINANCE) READILY
ACKNOWLEDGED URGENT NEED TO REVERSE DETERIORATION OF
SPANISH ECONOMY, BUT WAS MUTE ON SPECIFIC MEASURES WHICH
COULD BE IMPLEMENTED TO THIS END. SPANISH STRESSED
NECESSITY OF AVOIDING ECONOMIC ACTIONS WHICH WOULD RISK
UNSETTLING DELICATE POLITICAL SITUATION DURING PERIOD
PRECEDING JUNE 15 ELECTIONS. WHILE SPANISH WERE SOMEWHAT
MORE OPTIMISTIC CONCERNING LIKELY ECONOMIC DEVELOPMENTS
DURING BALANCE OF 1977, THEY NOTED THAT ECONOMIC POLICIES
AND HENCE FORECASTS WOULD DEPEND CRITICALLY ON COMPOSI-
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TION OF NEW GOVERNMENT. MOREOVER, SPANISH AND SECRETARIAT
AGREED THAT 1977 WOULD WITNESS RAPID INFLATION, SLOW
GROWTH AND LARGE CURRENT ACCOUNT DEFICIT. MANZANO UNDER-
LINED "INTERNATIONAL SOLIDARITY" AS IMPORTANT FACTOR WHICH
COULD HELP SPAIN RIDE OUT DIFFICULT ECONOMIC AND POLITICAL
PERIOD AHEAD. END SUMMARY

2. SHORT-TERM PROSPECTS; DOMESTIC OUTLOOK FOR 1977: SPANISH FORECAST SOMEWHAT HIGHER GDP GROWTH IN 1977 THAN DID SECRETARIAT (2.5 PERCENT VS. 2.3 PERCENT). WHILE SPANISH RELATIVELY OPTIMISTIC CONCERNING DEVELOPMENT OF MOST MAJOR DEMAND COMPONENTS, MAIN DIFFERENCE BETWEEN SECRETARIAT AND SPANISH LAY IN PROJECTED GROWTH OF GROSS FIXED CAPITAL FORMATION. SECRETARIAT FORECASTS DECLINE OF 0.3 PERCENT; SPANISH FORESEE INCREASE OF 2.5 PERCENT. SPANISH EXPLAINED THAT ADDITIONAL PUBLIC INVESTMENT EXPENDITURE (50 BILLION PESETAS) UNDER ECONOMIC ACTION PROGRAM WOULD STIMULATE PRIVATE INVESTMENT SPENDING. IN ADDITION, SPANISH FELT THAT INVESTMENT FOR RATIONALIZATION AND/OR REPLACEMENT PURPOSES WOULD PROVIDE BOOST TO CAPITAL FORMATION. IN SPANISH VIEW, INCREASE IN INVESTMENT COULD BE SUFFICIENT TO HALT RISE IN UNEMPLOYMENT.

3. WAGES AND PRICES: SECRETARIAT POINTED WITH CONCERN AT RAPID RISE IN AVERAGE HOURLY WAGE EARNINGS IN RECENT YEARS. SPANISH GAVE TORTUOUS, INCOMPREHENSIBLE AND UNCONVINCING EXPLANATION OF WHY WAGES HAD NOT RISEN AS RAPIDLY AS THE FIGURES INDICATED (E.G., 33.1 PERCENT ANNUAL RATE OF INCREASE BETWEEN NOVEMBER, 1976 AND NOVEMBER, 1975), BUT AGREED NONETHELESS THAT WAGE INCREASES HAD BEEN SUBSTANTIAL. SPANISH FORECAST 20 PERCENT INCREASE IN CONSUMER PRICES IN 1977 AND NOTED THAT THIS PROJECTION WAS MADE ON BASIS OF NEW (1976 BASE) PRICE INDEX. (IN VIEW OF FACT THAT REVISED CPI SHOWS PRICES RISING AT 30 PERCENT ANNUAL RATE IN FIRST QUARTER OF THIS YEAR, GOS FORECAST IMPLIES SIGNIFICANT DECELERATION OF PRICE INCREASES.)

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TION OF INFLATION RATE IN BALANCE OF 1977. SPANISH DID NOT INDICATE WHAT FACTORS MIGHT CONTRIBUTE TO IMPLIED MODERATION OF PRICE INCREASES.)

4. CURRENT ACCOUNT PROSPECTS FOR 1977: REVISED GOS FIGURES SHOW CURRENT ACCOUNT DEFICIT OF \$4.2 BILLION IN 1976, COMPARED WITH PREVIOUS GOS (AND SECRETARIAT) ESTIMATE OF \$4.4 BILLION. FOR 1977, SPANISH FORECAST 10 PERCENT INCREASE IN EXPORT VOLUME, 3 PERCENT RISE IN IMPORT VOLUME, 14 PERCENT INCREASE IN BOTH EXPORT AND IMPORT PRICES, SURPLUS ON SERVICES OF \$2.2 BILLION, AND \$3.8 BILLION CURRENT ACCOUNT DEFICIT. THEY ARE COUNTING ON LONG-TERM CAPITAL INFLOWS (PUBLIC AND PRIVATE) OF \$2.2 BILLION TO FINANCE LARGE PORTION OF 1977 DEFICIT, AND NOTED THAT REMAINDER WOULD BE COVERED THROUGH COMBINATION OF SHORT-TERM CAPITAL INFLOWS AND DRAWDOWN OF

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RESERVES (WITH RELATIVE PROPORTION OF LATTER FINANCING COMPONENTS YET TO BE DETERMINED). SPANISH DID NOT EXPECT TO ENCOUNTER EXTERNAL FINANCING DIFFICULTY IN 1977 AND STATED THAT THEIR \$5.0 BILLION IN RESERVES WOULD PROVIDE "MARGIN OF SAFETY." THEY NOTED (OF COURSE) THAT DEVALUATION OF PESETA IS NOT IN OFFING. INTEREST PAYMENTS ON EXTERNAL DEBT OUTSTANDING IN 1976 (\$11.0 BILLION AT END OF YEAR) ESTIMATED BY GOS AT 46 BILLION PESETAS. GOS FORECASTS RISE IN EXTERNAL DEBT TO \$13.2 BILLION BY END OF 1977; SPANISH CLAIMED NOT TO HAVE FIGURES ON ESTIMATED INTEREST AND AMORTIZATION PAYMENTS OVER NEXT FEW YEARS.

5. FISCAL AND MONETARY POLICY: ALTHOUGH BUDGET OF CENTRAL GOVERNMENT WAS INITIALLY FORECAST TO BE IN BALANCE, GOS NOW PROJECTS DEFICIT OF 40 BILLION PESETAS DUE TO ADDITIONAL SPENDING UNDER ECONOMIC ACTION PROGRAM. IN ADDITION, GOS CONTRACTED EXTERNAL LOAN OF \$1.0 BILLION IN 1976, EXPENDED PESETA COUNTERPART OF HALF THIS AMOUNT IN THAT YEAR, AND PLANS TO SPEND BALANCE IN 1977. ON MONETARY SIDE, SPANISH CHARACTERIZED OFFICIAL TARGET FOR LIMITED OFFICIAL USE

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GROWTH OF M1 IN 1977 (21 PERCENT) AS "ACCOMMODATIVE OR MILDLY RESTRICTIVE," AND ARGUED THAT ADOPTION OF SECRETARIAT'S RECOMMENDATION TO LOWER TARGET WOULD HAVE ADVERSE EFFECT ON INVESTMENT.

6. DISCUSSION OF WHAT SPECIFIC ECONOMIC POLICY MEASURES WOULD BE NECESSARY TO REVERSE DOWNWARD SPIRAL OF SPANISH ECONOMY WAS THIN AND INCONCLUSIVE. SPANISH STRESSED THAT GOS WILL AVOID TAKING ACTION WHICH COULD UNSETTLE THE POLITICAL SITUATION IN PERIOD IMMEDIATELY PRECEDING JUNE ELECTION. THEY ACKNOWLEDGED, HOWEVER, THAT ECONOMIC SITUATION WAS CRITICAL AND IN NEED OF URGENT REPAIR. THEY UNDERLINED NEED FOR "INTERNATIONAL SOLIDARITY" TO SEE THEM THROUGH DIFFICULT PERIOD AHEAD.
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